

Statement of

Matthew K. Rose

**President and CEO
Burlington Northern Santa Fe Corporation**



Before the

United States Senate

Committee on Commerce, Science, and Transportation

Subcommittee on Surface Transportation and Merchant Marine

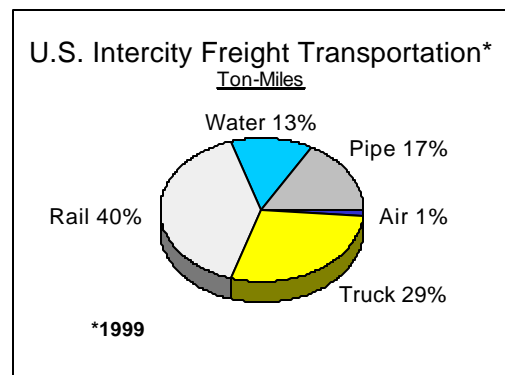
May 9, 2001

My name is Matthew K. Rose. I am President and Chief Executive Officer of Burlington Northern Santa Fe Corporation and The Burlington Northern and Santa Fe Railway Company (“BNSF”), 2650 Lou Menk Drive, Fort Worth, Texas. BNSF is one of America’s largest railroads, with about 39,000 employees and 33,500 miles of routes serving 28 states. BNSF handled over 8 million freight shipments last year and had revenues of \$9.2 billion. I have 20 years of experience in the freight transportation industry, including positions in operations and marketing with major railroads and trucking companies in both the eastern and western United States.

As requested by this Committee, the purpose of this testimony is to provide information about the financial condition of the railroad industry and changes since enactment of the Staggers Act in 1980. My testimony will explain why railroads are so crucial to our nation, and why railroads require massive amounts of capital. It will also demonstrate that although railroads have made great progress in the last 20 years, returns are still below the industry’s cost of capital, forcing significant constraints on future capital investments. This puts at risk our ability to meet future demand for rail transportation. I will conclude by addressing public policies that have the affect of “tilting” the competitive playing field against the railroads -- and in favor of other modes -- thereby preventing our nation from achieving the maximum benefits from its freight rail network.

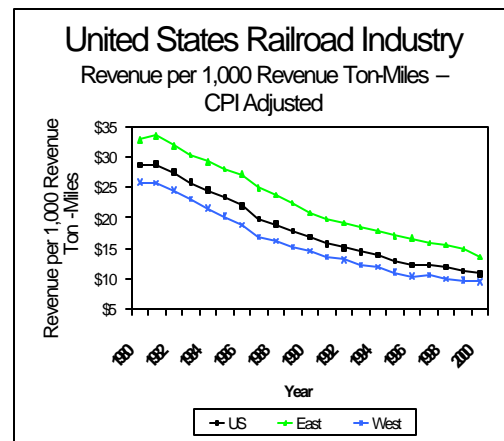
Freight Railroads Are Critically Important To Our Nation’s Future

Railroads are the “workhorses” of America’s transportation industry. Year after year, railroads handle more freight volume, by far, than any other mode. Railroads handle 40% of our nation’s freight measured in ton-miles, including 70% of the motor vehicles purchased

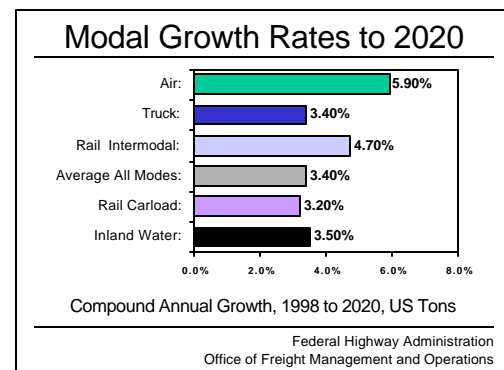


in our nation, 67% of the coal used for generating electricity, and 40% of our grain.

Over the last 20 years, rail ton-miles have increased 60%. During that time, however, competitive pressures forced rail prices steadily downward. The result was that rail industry revenues last year, adjusted for inflation, were 42% lower than 1980. Another important trend has been the shrinking geographic scope of our nation's rail freight network. Route-miles declined from 175,000 in 1980 to 132,000 in 2000 as competition from other modes intensified.¹



Over the next 20 years, our nation will be facing new freight transportation challenges. A recent study by the Federal Highway Administration Office of Freight Management and Operations forecasts that demand for freight transportation will double over the next 20 years. Rail carload and truck volumes are projected to grow by just over 3% per year, while rail intermodal is projected to have the highest growth rate among surface modes, at 4.7% per year.



Such projections beg key questions: Where is the capacity going to come from, and how are we going to pay for it? Only a few new highway, waterway and rail routes may be built. Clearly, our challenge is to develop public policies and business strategies to squeeze every bit of productivity from the infrastructure now in place, so that America's transportation system facilitates -- rather than constrains -- economic growth.

¹ Includes Class I, regional and short lines.

At the same time, the policies and strategies we adopt must protect our citizens and our environment, while providing competitive shipping rates and high service reliability.

Any way you look at it, railways will play a major role in addressing this challenge, because:

- Railroads are safer than alternative modes: Railroads have the lowest employee injury rate among all the modes. Our safety improvements of the past 20 years include a 65% decline in train accident rates and a 71% decline in employee injury rates.²
- Railroads are environmentally friendly. Freight trains are nearly five times more fuel efficient than trucks, and trucks emit anywhere from three to twelve times more pollutants per ton-mile, including nitrogen oxides and particulates.³
- Declining rail shipping rates are benefiting consumers. A study released last December by the Surface Transportation Board (“Rail Rates Continue Multi-Year Decline”) found that the ultimate beneficiaries of increases in rail productivity – and decreases in rail prices – have been consumers. A key finding of the study was that rail rates have fallen 45.3%, adjusted for inflation, since 1984. According to the STB, shippers would have paid an additional \$31.7 billion for rail service in 1999 if revenue per ton-mile had remained equal to the 1984 level. Another key finding was that “... all types of rail customers, and not just those with competitive transportation alternatives, have received some portions of the rate reductions.”

² The fatality rate for railroads is .86 per billion ton-miles, compared with 3.81 per billion ton-miles for tractor-trailer trucks. Based on analysis of data from the Bureau of Transportation Statistics and the National Highway Traffic Safety Administration

³ Railroads moved 383 revenue ton-miles per gallon of diesel fuel in 1999, compared with 80 revenue ton-miles per gallon for tractor-trailer trucks. Based on analysis of data from the Bureau of Transportation Statistics and AAR.

This industry study reflects what has happened at BNSF as well. There are numerous examples that confirm this decline. Two that stand out are coal and agricultural commodities. BNSF's average revenue per ton mile for coal shipped from the Powder River Basin in Wyoming declined 32%, adjusted for inflation, from 1994 through the first quarter of 2001, due to aggressive rail-to-rail and barge competition, our desire to keep generating plants from choosing alternative fuels, and competition between utilities.

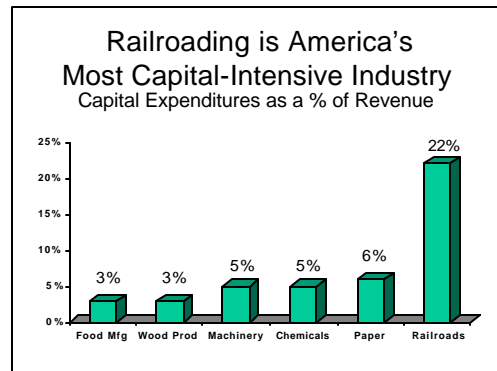
In the agricultural commodities area, BNSF's average revenue per ton-mile declined by 32%, adjusted for inflation, over the same period, due to competition with other railroads and other modes, and because we have passed efficiency gains through to customers in the form of lower rates in order to increase our business.

- Railroad service is improving: Last year, for the second consecutive year, BNSF provided its customers with 91% on-time service, up from 82% in 1998 and 79% in 1997. Excellent on-time performance for our largest customer, United Parcel Service, was one of our proudest achievements: We handled 388,190 UPS intermodal trailerloads during 2000, and delivered 99.6% of them on time. BNSF is continually sharpening its customer focus, including development of a number of e-business initiatives to make BNSF easier to do business with.

Even with these improvements, however, we understand that BNSF service is not as good as it needs to be across all commodities and across our entire network. But, it is getting better, year after year. The biggest key to further service improvements is undertaking the capital investments to increase the capacity of our infrastructure.

Railroads Require Massive Amounts Of Capital

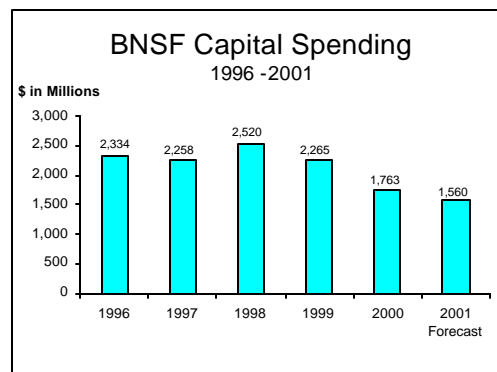
America's railroads, like all elements of our national transportation infrastructure, require massive investments for maintenance and capacity expansion. In fact, calling railroading capital intensive is an understatement. The U.S. Census Bureau



calculated that railroad capital expenditures in 1999 consumed a whopping 21.7% of revenues, compared with an average of just 3.9% for all manufacturers. Railroads require invested capital of about \$2.50 to generate a dollar of revenue, compared with just 50 cents of invested capital per revenue dollar for truckers.

At BNSF, wrestling with the capital investment dilemma is one of our biggest challenges. In the years immediately following the merger that created our company in 1995, we adopted an aggressive “build it and they will come” strategy. In our first five full years, we invested over \$11 billion -- an average of \$2.2 billion per year – to expand capacity and improve service. We acquired over 1,600 new locomotives, 6,000 covered hopper cars, added 1.6 million units of additional intermodal capacity and 496 miles of double and triple track, betting that we would attract additional business and increase our profitability.

This was a credible strategy, but it has not played-out rapidly enough. As a result, we have been essentially forced by our investors to significantly reduce our investment levels over the past three years. BNSF capital investments will drop to about \$1.5 billion this year. While these are substantial sums, and they are adequate to keep our railroad in quality running order, expenditures at this level will not get our company -- or our nation -- additional



capacity for handling the projected increased demand for rail freight transportation in the years ahead.

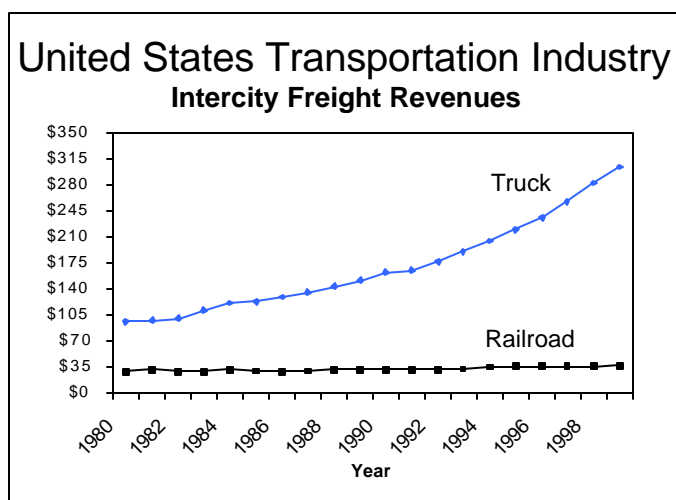
Declining capital investment levels have become the norm at the three other major Class I railroads in the last two years. Industry investment levels peaked at \$7.4 billion in 1998, and they are expected to decline to about \$5 billion this year. While it is natural for railroad investment levels to fluctuate from year to year, this trend bears watching closely.

The current excellent condition of most main line tracks, signal systems and locomotives on the Class I rail network gives us a bit of a cushion, but the weak earnings recently reported by the railroads, combined with the soft economic outlook for the quarters ahead, make it unlikely that investment levels will increase in the short term, and the current investment levels are close to the maintenance level.

It is important to keep in mind that the difference between capital investment intensity of railroad companies, compared with our competitors in other transportation modes, is not due to the high cost of railroad infrastructure. It is simply because railroad companies pay to maintain their own infrastructure, while our competitors do not.

Railroads may be the workhorses of our transportation system, especially when it comes to transporting bulk commodities over long distances, but despite great strides in efficiency, railroads are losing ground rapidly to truckers in revenue market share and tons originated. Unfortunately, history is proving

that rail technology typically does not have enough economic advantage to support

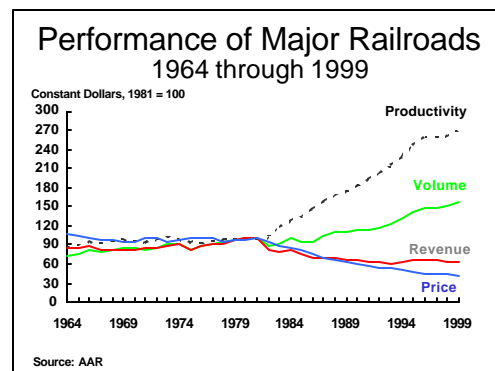


privately owned rights-of-way in the face of government-provided infrastructure for most of our competitors.

Despite Great Progress Railroads Are Not Profitable Enough To Attract Adequate
Capital To Fulfill Their Potential For The Nation

Most Americans probably would not put railroads near the top of their list of the most dynamic U.S. industries of the last 20 years, but they should. After two decades of stagnation in the 1960s and '70s, when returns on invested capital in the rail industry averaged only about 2%, economic deregulation breathed new life into the railroads.

Our industry responded with a vengeance, increasing returns to an average of 6.6% since deregulation. Since 1980, railroad productivity (expressed as ton-miles divided by operating expenses) has increased 203% (inflation adjusted), rail shipping rates have declined on average 62% (inflation adjusted), and industry revenues have declined 42% (inflation adjusted).



The railroad success formula of the last 20 years was relatively simple:

- Reduce expenses through a myriad of efficiency improvements;
- Trim operations back to the most profitable routes and commodities;
- Merge to extend single-line hauls, reduce overhead and achieve even greater efficiencies;
- Abandon or spin-off superfluous lines;
- Focus on customers.

One result of these initiatives was a considerable change in the mix of traffic transported by the railroads. Shipments of individual carloads of consumer and industrial goods, especially shorter haul shipments, failed to keep pace with economic growth as these shippers shifted to trucks.⁴ Numerous valiant marketing efforts to retain this business have been, at best, only modestly successful.

Today, we depend increasingly on bulk commodities and long-haul intermodal shipments in high density lanes. Intermodal is increasingly the “growth driver” for the industry. Western railroads have benefited relatively more than eastern carriers from these changes, because of their longer hauls and because the Clean Air Act resulted in surging demand for low-sulfur coal from Wyoming and Montana.

Most efficiencies achieved by the railroads have been passed-through to shippers in the form of lower prices, as STB studies have confirmed, due to competition and our need to increase volumes. Fortunately, because railroad expenses were reduced even more deeply than rates, railroads managed to keep some of the difference, which allowed the industry to gradually shore-up its finances.

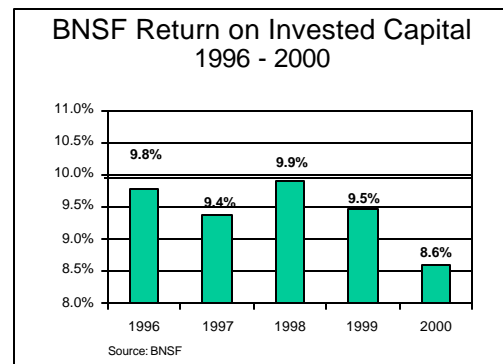
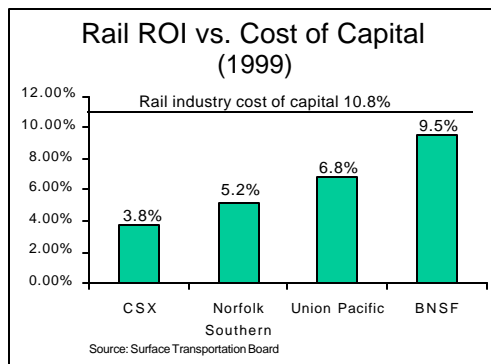
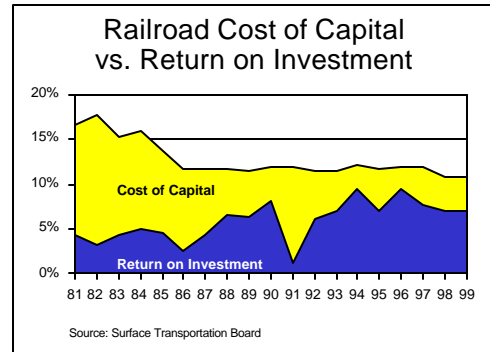
Railroads did this through “differential pricing,” which is the way virtually all industries set prices: costs, competitive factors, and the purchaser’s demand elasticity all get factored into the price equation. Some rail customers have argued to change this approach to pricing, but the changes they suggest would severely and immediately constrain our ability to make capital investments. Railroads should not be denied the same pricing mechanism as other service companies, especially since our industry is already subject to STB regulatory oversight concerning potential railroad market power abuse.

Unfortunately, the financial picture for railroads has not improved enough, and now we are seeing signs that it is slipping. Our industry’s “Achilles heel” is its inability to boost returns on invested capital above the cost of capital. This has troubled railroads for

⁴ Average length of haul for railroads increased from 615 miles in 1980 to 834 miles in 1999.

years, and it may well have more affect on our industry’s long-term future than any other financial measure. If railroads are unable to achieve returns exceeding their cost of capital, capital will flow out of the industry, railroads will constrict, and the economic, safety and environmental contributions of our industry to the nation will decline – at the very time they are most needed.

Progress has stalled since the mid-1990s, after making significant headway reducing the cost of capital “gap” during the 1980s. Although western railroads seem to be faring better than eastern roads in closing the gap between return on investment and cost of capital, BNSF’s slippage in this measure over the last three years is troubling.

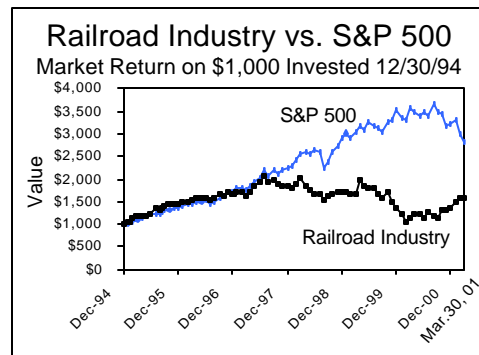


The key to managing our company to achieve returns greater than our cost of capital is to generate increased operating income from our assets. Because we own our infrastructure, our asset base is disproportionately large compared with competing transportation companies in other modes, and with other industries in general.

There are two levers available to manage our returns on invested capital. One is operating income, which is a factor of revenues, traffic volumes and expenses. The other lever is assets – our right-of-way, locomotives and facilities. It is my responsibility to achieve returns on capital in excess of capital costs by adjusting these two levers.

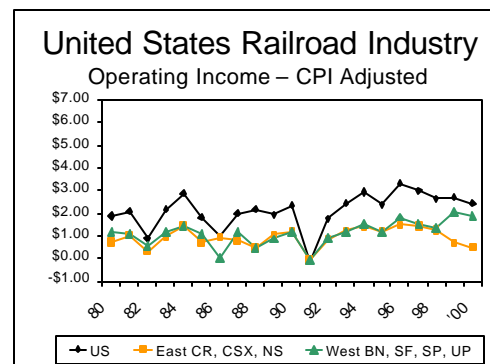
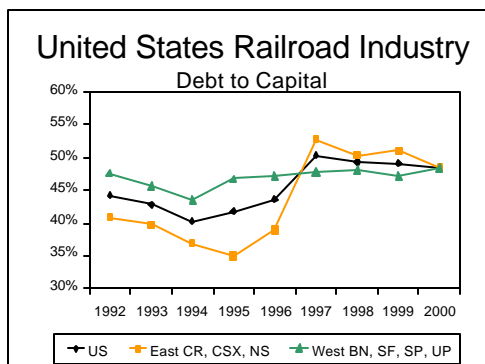
If BNSF does not make enough on the operating earnings side, we must pullback on assets associated with our lowest profit traffic, which has the effect of shrinking the company. Eventually, we will be “right sized” as the profitability of remaining traffic yields returns that exceed our cost of capital. That is simply the way free enterprise must work.

The equity markets assess our progress toward improving returns on invested capital constantly, and their evaluations are reflected in the day-to-day performance of our stock. Over the past several years, the market’s judgments have been harsh. Railroads in general, including BNSF, have lagged severely behind overall returns. The message from investors has been loud and clear: reduce capital investments, and generate increased cash flow.



At BNSF, we have been essentially forced by the markets to use much of the cash we generate to repurchase our stock. We have repurchased 93.9 million shares since our stock buy-back program began in July 1997, using \$2.4 billion in cash, and the program is continuing. Instead of plowing this capital back into the railroad, we have transferred it out of the company, to our shareholders. The disappointing thing is that despite this aggressive program, our stock performance remains substandard.

The Class I railroads are not in immediate financial danger. Current levels of net



operating income are disappointing, but debt levels are manageable by generally accepted business standards. In fact, barring a serious public policy mis-step such as re-regulation, it is highly unlikely we will ever see a repeat of rail industry crisis of the 1970s, with widespread bankruptcies, deferred maintenance, and declining safety. The Staggers Act gives management flexibility to avoid such outcomes.

The Class I railroads, however, could be on the threshold of a subtle, but nonetheless substantial erosion of rail freight capacity. Many short lines and regional carriers are struggling to attract maintenance capital, or simply to keep the doors open. Class I railroads must consider reducing the scope of their networks, if returns do not improve. We need to keep in mind that as the rail industry shrinks, potential public benefits from the railroads shrink correspondingly and our ability to facilitate the nation's economic growth is reduced

Recommendations

I am confident this Committee understands the potential benefits to our nation from a healthy freight rail system. The challenge ahead is to put the correct public policies in place to achieve these benefits.

In the midst of the debate, the Committee will hear dramatically different -- even contradictory -- recommendations for policy changes from various stakeholders. Too often, railroads, certain rail shippers, and some shipper associations will appear to be headed in opposite directions. There will be demands for Draconian policy changes that are not focused on improving services, but only on still lower prices for a select group of shippers. As I have pointed out, the railroads -- because of financial pressures -- are already being forced to cut operating expenses, employees, and capital investments. Cutting our revenues further will only make the challenges faced by the railroads more formidable.

I do not pretend to have all the answers to the railroad policy issues you will be addressing during this Congress, but I have several recommendations. They fall into three categories – short-term changes, public financing issues, and resisting pressures to turn back the clock.

Short-Term Policy Recommendations

Two policy issues stand out for the short-term: Elimination of the 4.3 cent per gallon “deficit reduction” diesel fuel tax paid by railroads, and reform of the Railroad Retirement system.

The deficit reduction fuel tax is a remnant of a past era, and it is discriminatory because proceeds from a similar tax paid by motor carriers are diverted to maintain their infrastructure. This tax costs BNSF about \$50 million annually, and railroad industry in total about \$170 million per year. Eliminating this tax would be an essential step forward.

Reform of Railroad Retirement is an even more important step toward modal equity. Last year, BNSF paid about \$350 million more into the Railroad Retirement system than we would have paid into social security, which is the pension system that covers our competitors in other modes. Our employees at BNSF contributed another \$100 million above and beyond what they would have paid into social security. Most of that amount, of course, was made-up indirectly by BNSF because we must stay competitive in labor markets to retain employees.

The deficit reduction fuel tax and the Railroad Retirement system combined cost BNSF about \$61 per freight shipment handled last year. That is a substantial burden, given that our net income per shipment was just \$120. Eliminating the fuel tax and reforming Railroad Retirement would be significant steps toward achieving competitive equity between modes and providing additional funds for expanding rail infrastructure.

Public Financing Recommendations

Access to capital for infrastructure investments is emerging as one of the biggest challenges for the railroad industry. The problem is that approximately 75% of the \$101 billion invested in America's rail industry is in rights-of-way, an investment category competitive modes simply do not have.⁵ While I am 100% committed to private sector ownership of rail infrastructure, I would like to see more aggressive public financing support for railroad projects that have clear, demonstrable public benefits, such as public safety enhancements, traffic congestion mitigation, or air quality improvements.

Across the nation, we are starting to see excellent examples of public/private financing partnerships that benefit both communities and railroads. Examples include the Alameda and *FAST* Corridors, capacity expansion projects to accommodate growing commuter and freight rail demands, and initiatives to relocate tracks away from congested downtown locations. While these examples are encouraging, we need to see many more such projects, with more community, state and federal funding support, and we need to see them completed faster.

Many major railroad infrastructure projects have associated public benefits. Whether it is constructing a new side track to move passenger or freight trains more efficiently through an urban area, expanding or building intermodal hubs, implementing a Positive Train Control system, or building more grade-crossing separations, all of these projects have real public benefits. Unfortunately, not enough projects like these will be undertaken without more funding.

The amount of public money that is spent on such projects is miniscule. Especially concerning to me is the small amount of funding available for grade-crossing projects, including crossing closures, constructing separations, and installing or upgrading signals. Last year, BNSF worked with communities to arrange closure of over 600 grade crossings across our system, and we have an equally ambitious plan this year.

⁵ Based on an analysis of rail industry "R-1" reports

Inadequate financing is the biggest barrier to closing even more crossings, to improve public safety and community livability.

I have been encouraged by the emerging dialog concerning increased public financing assistance for rail freight projects. I urge you to find ways to increase the amount of funding available for rail projects that have associated public benefits, including funding for short-line railroad infrastructure improvements (H.R. 1020), and to ensure that rail freight considerations are a high priority in the upcoming transportation reauthorization legislation.

Resist Pressures to “Turn Back the Clock” on the Staggers Act

My final recommendation is akin to the Hippocratic Oath: First, do no harm. It is impossible for me to overstate the harm to our industry that would result from reversing the differential pricing provisions of the Staggers Act, or imposing open access. Rail stocks would plummet, railroads would be forced to respond by sharply reducing capital investment levels, and the future of a rail industry with privately owned and maintained infrastructure would be jeopardized.

The railroad industry has come a long way in the last 20 years. Although there are challenges ahead, none are insurmountable. As was pointed out in this testimony, our industry needs your help to establish a level playing field with competitive modes. I look forward to assisting you any way I can.